

**LIETUVOS ENERGIJA AB**  
**Spin-Off Terms Assessment Report**

**Ernst & Young Baltic UAB**

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Lietuvos Energija AB  
Juozapavičiaus St. 13, LT-09310, Vilnius  
Republic of Lithuania

29 September 2009

Dear Sirs,

We have carried out an assessment of the terms of the Spin-Off of the branches, the Kaunas Hydropower Plant (hereinafter 'Kauno HE') and the Kruonis Pumped Storage Plant (hereinafter 'Kruonio HAE'), of the Public Company Lietuvos Energija (hereinafter 'Lietuvos Energija AB' or 'the Company') and have prepared an Assessment Report (Annex 1). The assessment was carried out pursuant to Articles 63(2) and 63(3) of the Law on companies of the Republic of Lithuania and the provisions of the Civil Code and is limited to the application of laws of the Republic of Lithuania.

In carrying out the assessment of the Spin-Off Terms, we were guided by the documents and information provided to us by representatives of Lietuvos Energija AB. No additional queries were made to any third parties with a view to receiving further information.

The assessment of the Spin-Off Terms was carried out on the basis of the assumption that all the documents and the data contained therein that were provided to us were true and reflected the existing situation, that all signatures and seals on the documents were authentic, that copies of the documents were exact copies of their originals and that the documents were not amended or supplemented after their submittal for our assessment. We did not verify the correctness and the level of detail of all information provided to us, except for the cases discussed in the Report. Our assessment does not cover any other documents of Lietuvos Energija AB, Kauno HE and Kruonio HAE, except for those listed in Annex 2, but is limited to information and documents which were provided to us for assessment purposes. Nor do we assume an obligation to update the Assessment Report if any changes become known after the date of the submittal of the Report.

The scope of the work carried out by us is considerably narrower than that of an audit or a special purpose review carried out with a view to expressing an opinion on the financial and further information of Lietuvos Energija AB or Kauno HE and Kruonio HAE, pursuant to the International Auditing Standards or other applicable professional standards. In the event that an audit or a special purpose review was carried out, our assessment would be subject to different purposes and different conclusions, comments or recommendations could be provided.

Respectfully,  
*/Signature/*

Ramūnas Bartašius  
Auditor

Auditor Certificate No 000362

## **Annex No 1**

### **ASSESSMENT REPORT**

#### **I. General comments**

AB Lietuvos Energija, legal form of the legal entity: public company, legal address: Žvejų St. 14, Vilnius, Republic of Lithuania, legal entity registration No: 220551550, data about the legal entity collected and stored in the Registry of Legal Entities of the Republic of Lithuania, Registry Manager: Vilnius Office of the Public Enterprise Registry Centre (hereinafter referred to as 'AB Lietuvos Energija'), the spin-off of which is carried out pursuant to Article 71 of the Law on companies of the Republic of Lithuania.

The Public Company AB Lietuvos Energija (hereinafter 'AB Lietuvos Energija') which will continue its activities after the spin-off shall split a part for establishing, on the basis of assets, rights and liabilities designated thereto, two companies of the same legal form, i.e. the Public Company Kaunas Hydropower Plant (hereinafter 'AB Kaunas Hydropower Plant' or 'AB Kauno HE') and the Public Company Kruonis Pumped Storage Plant (hereinafter 'AB Kruonis Pumped Storage Plant' or 'AB Kruonio HAE'). The spin-off process shall be carried out *mutatis mutandis* pursuant to the provisions of the Civil Code and of the Law on companies of the Republic of Lithuania regulating reorganisation by way of division.

The company to continue its activities and to operate after the Spin-Off shall be AB Lietuvos Energija. The New Spin-Offs to be established and to operate after the Spin-Off shall be AB Kaunas Hydropower Plant and AB Kruonis Pumped Storage Plant.

#### **II. Comments on the Spin-Off Terms**

##### *1. Purpose of the Spin-Off*

The purpose of this Spin-Off is the implementation of the provisions of point 4.1 of the Agreement of 29 April 2008 on the Establishment of the National Investor between the Government of the Republic of Lithuania and UAB NDX Energija.

##### *2. Content of the Spin-Off*

The Spin-Off Terms have been drawn up pursuant to the provisions of Articles 63 and 71 of the Law on companies of the Republic of Lithuania. The Spin-Off Terms discuss and define all the aspects of the Spin-Off provided for in the Law.

##### *3. Transfer of assets, rights and liabilities*

Pursuant to section 10 of the Spin-Off Terms, the New Spin-Off, AB Kaunas Hydropower Plant, established during the Spin-Off, will take over from AB Lietuvos Energija the assets, rights and liabilities relating to the activities of the branch of AB Lietuvos Energija which is engaged in electricity production and the storage of reserve capacity in the Kaunas Hydropower Plant, and the New Spin-Off, AB Kruonis Pumped Storage Plant, will take over from AB Lietuvos Energija the assets, rights and liabilities relating to the activities of the branch of AB Lietuvos Energija which is engaged in electricity production and the storage of reserve capacity in the Kruonis Pumped Storage Plant. All the other assets, rights and liabilities will stay in AB Lietuvos Energija.

The assets, rights and liabilities of AB Lietuvos Energija will be transferred within the time limits and under the procedure laid down in the Spin-Off Terms, pursuant to the Acceptance and Transfer Report, according to the principles specified in the Spin-Off Terms (Annex 3 to the Spin-Off Terms). The Spin-Off shall be deemed completed from the moment of registration of the amended Articles of the Association of AB

Lietuvos Energija and of the New Spin-Offs, AB Kaunas Hydropower Plant and AB Kruonis Pumped Storage Plant, with the Registry of Legal Entities.

4. Rights granted to members of the bodies of the Company and to experts carrying out the assessment of the Spin-Off Terms for the time of the Spin-Off

Pursuant to section 14 of the Spin-Off Terms, the General Meeting of Shareholders, the chief executive and the Board of AB Lietuvos Energija and experts carrying out the assessment of the Spin-Off Terms, during the time of the Spin-Off, shall have all rights granted to them by laws, agreements made and the Articles of Association of the Company. The above persons shall not receive any additional rights.

Decisions on the unbundling of Kauno HE and Kruonio HAE from AB Lietuvos Energija will be taken and the Spin-Off Terms will be approved by the General Meeting of Shareholders of AB Lietuvos Energija.

### **III. Conclusions regarding the fairness and justification of the share exchange ratio**

Prior to the Spin-Off, the subscribed capital of AB Lietuvos Energija shall equal LTL 689 515 435 (six hundred eighty-nine million five hundred fifteen thousand four hundred thirty-five litas), which shall be divided into 689 515 435 (six hundred eighty-nine million five hundred fifteen thousand four hundred thirty-five) ordinary registered shares of the nominal value of LTL 1 (one litas).

Pursuant to section 7 of the Spin-Off Terms, after the Spin-Off, the subscribed capital of AB Lietuvos Energija shall equal LTL 566 057 704 (five hundred sixty-six million fifty-seven thousand seven hundred and four litas), which shall be divided into 566 057 704 (five hundred sixty-six million fifty-seven thousand seven hundred and four) ordinary registered shares of the nominal value of LTL 1 (one litas).

After the Spin-Off, the subscribed capital of AB Kaunas Hydropower Plant shall equal LTL 23 782 035 (twenty-three million seven hundred eighty-two thousand and thirty-five litas), which shall be divided into 23 782 035 (twenty-three million seven hundred eighty-two thousand and thirty-five) ordinary registered shares of the nominal value of LTL 1 (one litas).

After the Spin-Off, the subscribed capital of AB Kruonis Pumped Storage Plant shall equal LTL 99 675 696 (ninety-nine million six hundred seventy-five thousand six hundred ninety-six litas), which shall be divided into 99 675 696 (ninety-nine million six hundred seventy-five thousand six hundred ninety-six) ordinary registered shares of the nominal value of LTL 1 (one litas).

After the Spin-Off, all shares of AB Kaunas Hydropower Plant and AB Kruonis Pumped Storage Plant shall be transferred free of charge to the ownership of the shareholders in exchange for the shares of AB Lietuvos Energija to be cancelled after the Spin-Off.

During the Spin-Off, AB Lietuvos Energija shall reduce its capital pro rata to the sum of the net assets (as a total of assets, rights and liabilities) transferred to Kauno HE and Kruonio HAE, through the formation of the subscribed capital (in litas) of AB Kaunas Hydropower Plant and AB Kruonis Pumped Storage Plant:

	AB Lietuvos Energija prior to Spin-Off	After Spin-Off		
		AB Lietuvos Energija	AB Kruonio HAE	AB Kauno HE
Subscribed capital	689 515 435	566 057 704	99 675 696	23 782 035
Percentage (%) of subscribed capital prior to Spin-Off	100	82.095	14.456	3.449
Net assets (total assets net of liabilities,	2 570 985 904	2 110 650 907	371 659 279	88 675 718

including grants and subsidies, total)				
Percentage (%) of net assets prior to Spin-Off	100	82.095	14.456	3.449
Book value per share (rounded)	3.729	3.729	3.729	3.729

Pursuant to point 7.6 of the Spin-Off Terms, the number of shares of AB Lietuvos Energija held by each Shareholder of AB Lietuvos Energija after the Spin-Off of AB Lietuvos Energija shall be calculated by multiplying the number of shares of AB Lietuvos Energija held by the Shareholder by a factor of 0.8209500113, taking into account the rules of rounding laid down in the Spin-Off Terms.

Pursuant to point 7.10 of the Spin-Off Terms, the number of shares of AB Kaunas Hydropower Plant held by each shareholder of AB Kaunas Hydropower Plant after the Spin-Off of AB Lietuvos Energija shall be calculated by multiplying the number of shares of AB Lietuvos Energija held by the Shareholder by a factor of 0.0344909390, taking into account the rules of rounding laid down in the Spin-Off Terms.

Pursuant to point 7.14 of the Spin-Off Terms, the number of shares of AB Kruonis Pumped Storage Plant held by each shareholder of AB Kruonis Pumped Storage Plant after the Spin-Off of AB Lietuvos Energija shall be calculated by multiplying the number of shares of AB Lietuvos Energija held by the Shareholder by a factor of 0.1445590497, taking into account the rules of rounding laid down in the Spin-Off Terms.

The fairness of the share exchange ratio depends on the appropriateness of the determination of the fair values of the shares exchanged. The methods used to calculate the share exchange ratio are discussed in Chapter IV.

Further analysis of the above table shows that the book (rounded) value per share of AB Lietuvos Energija prior to the Spin-Off and the book (rounded) value per share of AB Kauno HE, AB Kruonio HAE and AB Lietuvos Energija operating after the Spin-Off is identical and equal to LTL 3.729.

In our opinion, based on the assumptions specified herein, the share exchange ratio indicated in the Spin-Off Terms is justified and fair in all material respects.

#### **IV. Methods used for determining the share exchange ratio and conclusions regarding the appropriateness of those methods and their influence on determining the share value**

The share exchange ratio could be best based on fair (market) prices. Determining the fair market value requires thorough analysis and, in general terms, taking into account the case under consideration, the share price could be determined by business appraisers.

According to the Spin-Off Terms, the Spin-Off is carried out so that the number of shares of AB Kauno HE and AB Kruonio HAE and of AB Lietuvos Energija that will continue its operations after the Spin-Off is directly prorated to the shareholdings of their shareholders in the Shareholders' equity of AB Lietuvos Energija prior to the Spin-Off, i.e. each existing Shareholder of AB Lietuvos Energija retains the same right to the ownership of a share of the business of AB Lietuvos Energija both prior to and after the Spin-Off (the sum of the rights to the ownership of the businesses of AB Lietuvos Energija, AB Kauno HE and AB Kruonio HAE that will operate after the Spin-Off), taking into account the rules of rounding and distribution of shares (which has no material effect on the shareholders' interests due to the insignificance of the influence of such rounding on the absolute sums), as stated hereunder, and there would be no difference whether the Spin-Off is carried out on the basis of the fair value of the business or of the book value.

Pursuant to the provisions of the Law on companies, management of AB Lietuvos Energija participating in the Spin-Off have drawn up the Spin-Off Terms wherein they stated the assumptions and the justification that served as the basis for determining the share exchange ratio. Our analysis is provided hereunder.

#### AB Lietuvos Energija share value

Pursuant to the provisions of the Agreement of 29 April 2008 on the Establishment of the National Investor between the Government of the Republic of Lithuania and UAB NDX Energija regarding the transfer of the assets and liabilities of Kruonio HAE and Kauno HE, management of AB Lietuvos Energija have calculated the share exchange ratio on the basis of the book value of the shares and net assets subject to the spin-off.

The interim Financial Statements (Annex 5 to the Spin-Off Terms) for the six months ended 30 April 2009, reviewed by the auditors, specify that the book value of the owners' equity of the company constitutes LTL 2 570 985 000 and the total number of shares equals 689 515 435, resulting in the book value of LTL 3.729 per share.

#### AB Kauno HE and AB Kruonio HAE shares

According to the draft Balance Sheets of AB Kauno HE and AB Kruonio HAE (Annex 2 to the Spin-Off Terms), net assets (assets net of liabilities) of AB Kruonio HAE subject to transfer equal LTL 371 659 279, while those of AB Kauno HE make up LTL 88 675 718, which would be equivalent to 99 675 731 and 23 782 043 shares of the Company designated to the spin-off parts. Under the Spin-Off Terms, 99 675 731 and 23 782 043 shares of the Company shall be exchanged for the same number of share of the unbundled companies, AB Kruonio HAE and AB Kauno HE. Differences arising from rounding are insignificant.

In the Spin-Off Terms, the size of the subscribed capital of the Company continuing its operations and of the newly-established companies is determined pro rata to the net value of the assets and liabilities of the unbundled business, and also a proportional share exchange ratio is set, which in fact is correct when applying the selected method for determining the spin-off parts.

### **V. Description of difficulties of the assessment**

The major difficulties that arose in the course of the assessment were the following:

- Some of the aspects relating to the designation of assets and liabilities to individual companies were not discussed in the Agreement on the Establishment of the National Investor of 29 April 2008 between the Government of the Republic of Lithuania and NDX Energija UAB. Management of Lietuvos Energija AB have described appropriate assumptions made for drawing up the draft Balance Sheets, in the Principles of Drawing up the Draft Balance Sheets provided in the Annex to the Spin-Off Terms.
- The interim Financial Statements of Lietuvos Energija AB as of 30 June 2009 have been reviewed by the auditors, but they have not been audited. In addition, the Balance Sheets of Kruonio HAE and Kauno HE subject to the Spin-Off have not been audited;
- The auditors' review report on the interim Financial Statements of Lietuvos Energija AB as of 30 June 2009 contains a point on the emphasis of the subject matter regarding:
  - (a) the uncertainty relating to the interpretation of the conditions of the Agreement on the Establishment of the National Investor of 29 April 2008 between the Government of the Republic of Lithuania and NDX Energija UAB, with respect to the Spin-Off of Kauno HE and Kruonio HAE. Management's assumptions regarding the interpretation of the Agreement, made for drawing up the Spin-Off Terms are provided in the Principles of Drawing up the Draft Balance Sheets contained in the Annex to the Spin-Off Terms;

- (b) the uncertainty relating to the setting of regulated prices and tariffs of services in the future, which may have a significant influence on the recoverable amount of non-current assets. According to management of Lietuvos Energija AB:

*“Following reorganisation of Lietuvos Energija AB by establishing AB Kruonio HAE and AB Kauno HE from Lietuvos Energija AB by way of division, both Lietuvos Energija AB which will continue its activities and the newly-established companies, AB Kruonio HAE and AB Kauno HE, will have financial capability to carry out their activities:*

- The major part of income of Lietuvos Energija AB will consist of income from the electricity transmission service the price of which is subject to regulation. At present, the price of the electricity transmission service makes up 2.2 ct/kWh. The price was significantly lower (by about 45 pct) than the cap on the price of transmission approved earlier and effective at present.*
- On 23 September 2009, a new Methodology for setting prices and caps on prices for electricity transmission and distribution was adopted. According to the calculations of the new cap on the price for transmission under this methodology, based on preliminary assessment, this cap will stay higher than the tariff effective at present, which, according to our calculations, could make up between 2.7 and 2.8 ct/kWh.*
- Upon the spin-off of AB Kauno HE and AB Kruonio HAE, Lietuvos Energija AB will have to purchase electricity intended for covering the technological losses in the networks at a market price (presently, electricity generated at Kauno HE is used for this purpose). This will result in an increase of about LTL 60 million in the costs of Lietuvos Energija AB, which were not included when setting the price for the transmission service. However, point 30 of the new Methodology for setting prices and caps on prices for electricity transmission and distribution stipulates the following: “30. In calculating the costs of purchasing electricity used for its transmission in technological installations, an assumption is made that electricity intended for this purpose is purchased in the market at a price which is not higher than the expected price on the exchange (at auction)”. A higher cap on the price of the transmission service will allow the company to apply for a review of the effective price for transmission, by covering the said additional costs, while AB Kauno HE will have an opportunity to operate under market conditions.*
- On the other hand, the Company implements programmes for optimising its operations that will enable the Company to balance its cash flows even without increasing the transmission tariff.*
- AB Kruonio HAE will earn income from the sale of peak electricity and the storage of reserve capacity. The price for the service of the secondary storage of reserve capacity is also subject to regulation. The new draft Procedure for the regulation of electricity and active reserve capacity prices for producers and independent suppliers who control more than 25 percent of the market establishes that the setting of the price for the secondary storage of reserve capacity may include relatively fixed costs necessary for maintaining the secondary reserve capacity and the regulatory profit not to exceed 5 percent of non-current tangible assets used to carry out activities subject to regulation.*
- AB Kauno HE will earn income from the sale of electricity in the market. It is estimated that the electricity price in Lithuania after the decommissioning of the Ignalina Nuclear Power Plant will be not lower than 14 or 15 ct/kWh, i.e. several times higher than the cost price of electricity produced at Kauno HE.”*

We did not verify the above analysis provided by management.

No other difficulties were encountered in the course of the assessment.

## **Annex No 2**

### **LIST OF DOCUMENTS**

1. Spin-Off Terms of the Public Company Lietuvos Energija (with annexes), approved by the Board Meeting of the Public Company Lietuvos Energija of 29 September 2009.
2. Interim Financial Statements of AB Lietuvos Energija for the six months ended 30 April 2009, prior to the Spin-Off (reviewed by the auditors).
3. Balance Sheet and Profit (Loss) Statement of AB Lietuvos Energija as of 30 April 2009, after the Spin-Off.
4. Unaudited Balance Sheet and Profit (Loss) Statement of AB Kaunas Hydropower Plant as of 30 April 2009, after the Spin-Off.
5. Unaudited Balance Sheet and Profit (Loss) Statement of AB Kruonis Pumped Storage Plant as of 30 April 2009, after the Spin-Off.
6. Report of the Board of the Public Company Lietuvos Energija on the planned spin-off, approved by the Board Meeting of the Public Company Lietuvos Energija of 29 September 2009.